

TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

August 22, 1980

Prefatory Note

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FEDERAL OPEN MARKET COMMITTEE
CONFERENCE CALL
August 22, 1980

PRESENT: Mr. Volcker, Chairman
Mr. Gramley
Mr. Guffey
Mr. Morris
Mr. Partee
Mr. Rice
Mr. Roos
Mr. Schultz
Mr. Solomon
Ms. Teeters
Mr. Wallich
Mr. Winn

Messrs. Balles, Baughman, Eastburn, and Mayo, Alternate Members of the
Federal Open Market Committee

Messrs. Black, Corrigan, and Ford, Presidents of the Federal Reserve Banks
of Richmond, Minneapolis, and Atlanta respectively

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. Petersen, General Counsel
Mr. Mannion, Assistant General Counsel

Messrs. J. Davis, Ettin, Henry, Kichline, Truman, and Zeisel,
Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market
Account

Mr. Coyne, Assistant to the Board, Office of Board Members, Board of
Governors
Mr. Prell, Associate Director, Division of Research and Statistics,
Board of Governors
Mr. Beck, Senior Economist, Division of Research and Statistics,
Board of Governors
Mrs. Steele, Economist, Open Market Secretariat, Board of Governors

Mr. Scheld, Senior Vice President, Federal Reserve Bank of Chicago

Transcript of Federal Open Market Committee Conference Call of
August 22, 1980

CHAIRMAN VOLCKER. I hope we can be relatively brief this morning, but I thought it might be a good idea to touch base. I hope to be out next week and the beginning of the following week, and in fact we're going to have a paucity of Governors in Washington during part of that period. But we have Mr. Schultz eating lunch at the table in preparation for leaving this afternoon so that he will be here with full strength next week and able to take care of all problems.

Apart from some prospective absences, we've obviously had some big changes in the money figures and I just wanted to run over the consequences of those changes for the targets and what the projections are. I assume, as always, that our projections are both unbiased and not very reliable. They don't necessarily show quite as frightening a picture as the most recent numbers suggest; the recent numbers are not very good. Maybe Mr. Ettin can go over where we stand--what we are publishing this afternoon, so far as we know at the moment--and what the outlook is as he sees it.

MR. ETTIN. Thank you, Mr. Chairman. This afternoon we will be publishing an upward revision to the August 6th M-1A that will show an increase from the previous week of--

MR. TIMLEN. We can't hear at all in New York.

CHAIRMAN VOLCKER. Could you hear me all that easily?

MR. TIMLEN. I can hear you, Paul, but that's all.

CHAIRMAN VOLCKER. We'll get Mr. Ettin to a different station [and microphone].

SPEAKER(?). Put him here.

MR. ETTIN. Can you hear now?

SPEAKER(?). Quite well.

MR. ETTIN. All right. This afternoon we will be publishing a revision for the week of August 6th, which will show that M-1A was up \$9.7 billion instead of the previously published \$8.2 billion. For M-1B we will publish a revised August 6th figure that will be up \$10.4 billion rather than the previously published \$8.9 billion. For the week of the 13th, to be published for the first time this afternoon, we will show for M-1A a decline of \$3.6 billion from the upward revised August 6th level and for M-1B a decline of \$3.4 billion from the revised August 6th level.

Board Staff estimates based on the preliminary data through August 20th suggest that M-1A in August will rise at a 15 percent [annual] rate and M-1B at a 17-1/4 percent rate. Our projection for September for M-1A at this time is for virtually no change; and for M-1B we estimate growth of perhaps between 1 and 2 percent.

CHAIRMAN VOLCKER. Let me say just one other thing: What

obviously partial and not very reliable data we have for the week of the 20th indicate a decline of \$1 to \$1-1/2 billion, so that September figure is not projecting anything startling other than some mild increase from a lower level that we would have reached at the end of August. It's not out of the clear blue sky in that sense. It doesn't require any heroic assumptions as to what happens in September; it just says September will increase a little from what we now think the latter part of August will be. So what falls out of that is practically an unchanged September on a daily average basis. Obviously these August figures look very big; if we could put any weight on the September figure--and obviously we can't put all that much weight on it--the two months together are not all that startlingly above what we were talking about. I have those figures here someplace.

MR. ETTIN. For the two months, the Board's staff would be looking at about an 8 percent increase as opposed to the "about 6 percent" that was targeted by the Committee.

CHAIRMAN VOLCKER. Yes, that's right. [For the third quarter] M-1B is a little less than 9-1/2 percent as against [the Committee's objective of about] 8 percent. And M2 is practically what we said on these projections. M2 has been running a little low relative to the other numbers--it was running high as you recall and we had some discussion of it--partly because growth in money market funds has turned negative now. So we're very close on these projections to the M2 target for this quarter. For M-1A and M-1B we're clearly above, but it's not by any means out of sight [even with] the August figure, if the September number is more or less right.

What this implies for reserve targeting, as we discussed at the meeting, is that of course the borrowings go up. The path has not been worked out in any detail; it is complicated by the fact that we had a substantial miss in the last week, which meant we had more nonborrowed reserves than we thought we had and less borrowings on the other side. So there's a judgmental question on the path as to whether to let that bygone be a bygone or whether mechanically to make up for it in the rest of the period. In any event whatever adjustment we make, we would expect the borrowings to go up and they really haven't gone up yet. But the market has certainly been anticipating some tightening and it's a question of how much the markets are going to react to these figures today. Peter may want to comment on that. My sense of it is that the figures aren't going to make them happy, but I don't know. I'm not sure they are so bad that it will provoke a big further adjustment. Peter, do you have some comment on that?

MR. STERNLIGHT. I think at first blush they will be slightly pleased at the approximately \$3-1/2 billion decline. Then they'll get to looking at the upward revision and become a little more concerned about it. On balance, I think it's going to be a slight negative.

CHAIRMAN VOLCKER. I don't know whether Mr. Kichline wants to report on any economic data we have had in the past week. We had a consumer price index this morning, which you probably all know about.

MR. KICHLINE. Yes. The consumer price index this morning, as you know, showed no change. It was a bit lower than we had

anticipated. Food prices, although rising, rose a little less than we expected; and the mortgage rate contributed a major influence and declined substantially. We expect the mortgage rate to go down further in the CPI index for next month. We've also received new orders figures, which were up appreciably for total durable goods and they rose for nondefense capital goods also. We do not believe, however, that the current [GNP] forecast for the third quarter, showing a decline of 4 percent or so, would be changed on the basis of the information that has become available since the meeting.

CHAIRMAN VOLCKER. We, of course, had a bad producer price index. That was since the meeting, wasn't it?

MR. KICHLINE. Yes.

CHAIRMAN VOLCKER. Having that big increase in producer prices didn't help the market, obviously. Market participants may be looking at that more than the consumer prices because they can dismiss the consumer price number as a mortgage phenomenon. But the consumer price index did not look too bad outside the mortgage area. As I remember it was 0.6 outside--

MR. KICHLINE. That's right. If you take out the mortgage component, it was up 0.6 percent, which is unchanged from the rate of increase in the preceding month.

CHAIRMAN VOLCKER. Well, we have had a very substantial adjustment in the longer-term rate area and, of course, we've had an adjustment in the short-term rate area, too. I don't have the figures in front of me, but my impression is that the adjustment in long-term rates is as big or bigger than the adjustment in short-term rates, which is somewhat of an abnormal experience. We have essentially an unchanged economic situation from what we thought before.

I would just say that I feel a little sensitive about the manner in which we conduct our open market operations. [I'm talking] not in terms of anything we've done which needed to be done, but I think we should try to avoid resolving any doubts on the side of taking overt action in the market at a time when the market is already very sensitive--if we can get by with it consistent with the path. Just as a matter of judging hourly operations or daily operations--but it's a tricky business--I wouldn't want to see any unnecessary messages sent to the market, consistent with the kind of path and the anticipation of higher borrowings that we have. The discount rate, of course, is at 10 percent. And with this level of borrowings one would expect--as with any significant level of borrowings, which we are certainly looking for--that the funds rate would normally trade above the discount rate. I think that's the prospect we face based upon the information we know at the moment. How much of that has been discounted in the market, I don't know. I don't know whether anybody else has any comments they want to make at this point.

MR. SCHULTZ. Do you want to tell [the Presidents] what we did with the discount rate this morning?

CHAIRMAN VOLCKER. Fred is just saying that we did, after a relatively short debate and purely because of the potential confusion involved, accept the proposals we had from several Reserve Banks to

conform this ineligible paper discount rate to the regular discount rate on September 1st. The announcement will present this as an action taken to bring those rates in conformity in the light of the authority and the basic intention implied by the Monetary Control Act. In Mr. Coyne's professional judgment, it will get no attention in the press. We will see.

MR. ROOS. Paul, Larry Roos. Is there any intention to withdraw some reserves in order to compensate for the overshoot in the last week or so?

CHAIRMAN VOLCKER. By "overshoot" you mean the error in the nonborrowed reserve figure, I assume?

MR. ROOS. Yes, sir.

CHAIRMAN VOLCKER. That probably falls into an area of some discretion. It amounts to something like \$70 million when averaged over the remaining weeks, so we're not talking about a huge number. But I would be inclined not to be very eager to make up for that overshoot depending upon whether we overtly had to take it out or not. That would be my judgment. In other words, if it made the difference between going into the market overtly, particularly in an atmosphere where the market is already weak, I would swallow it. If the market makes it up itself without us--because that's the way the operating factors are going--then it would be okay. That judgment has to be made almost from day to day, but that's the way I would look at it, Larry.

MR. ROOS. Where did the reserves come from to support the money supply increase?

CHAIRMAN VOLCKER. Where did the reserves come from to support the money supply increase? They didn't come from anywhere. That's the trouble. We have a lagged reserve accounting system and no reserves are needed to support it in the first instance. So what we're basically talking about is how many of those reserves have to come out of borrowing now that it's effective in the market, I guess this week. We're saying that those reserves basically have to come out of borrowing. That is the normal path assumption: That those additional reserves will come out of borrowing. Now, what will happen to excess reserves and whether we will get another error or whatever [is another question], but the normal [assumption in terms] of the path is that those reserves come out of borrowing. The reason the reserve miss was in the most recent week, not the week when the money supply went [up]--was that the week before that they had to put up the reserves for the money supply increase. Well, I don't know, I get mixed up regarding the particular weeks, but the reserve miss was not in the week that the money supply increased. And it was due to float on the last day.

MR. CORRIGAN. Paul, this is Jerry Corrigan. I understand what you said about the problems the staff is having with the path. But what is the sense, [given] everything we know right now, as to what may happen to the funds rate in the immediate period ahead--in the next couple of weeks or so?

CHAIRMAN VOLCKER. We would expect it to be up, based upon what we know now.

MR. CORRIGAN. I appreciate that. Is there any sense of how much it might have to go up given what's going to happen to borrowing?

CHAIRMAN VOLCKER. What is the rate now, 10-1/4 percent?

MR. ETTIN. 10 to 10-1/4.

CHAIRMAN VOLCKER. I suppose it could go up in the neighborhood of a percentage point under normal relationships.

MR. PARTEE. As high as 11 percent.

CHAIRMAN VOLCKER. Yes. As you know, these are not very close relationships, but that's the average implication I guess. All I am saying is that it's one thing if that [increase] seems to be happening kind of normally. I don't particularly want to give the market the idea that we have a higher funds rate target. That's the point.

MR. CORRIGAN. I appreciate that.

CHAIRMAN VOLCKER. I'm not responding to your direct question, Larry, but let me ask a different question, which is somewhat related. It is very troublesome to me, and I am sure to other people, that the money supply can jump up by \$9 or \$10 billion in a week the way it [apparently has recently]. That is a monthly increase in the money supply that's half the normal increase for a whole year. And nobody knows why. I have gotten no enlightenment on it either. Well, we think some of it may have been due to social security payments, but the staff presumably tried to adjust for that in the seasonal. So even there, [though] we know the social security payment has an impact on the money supply it is not clear that that wasn't adjusted out.

We haven't had much guidance here. I haven't heard any reasons from the experts in New York and I haven't heard any plausible explanations from the market. Here we have, as I say, a money supply increase in a week that's equal to roughly half of the normal increase for a year, and nobody in the world seems to have even much of a speculation as to what is going on, what caused it, and whether it's [temporary]. Well, we have some sense that it is temporary; we naturally think it tends to be temporary simply because it's so big. And the most recent data somewhat confirm that, at least in a partial sense. All I am saying is that if anybody has any acute insights as to what has been going on in the last few weeks, I would be very interested in hearing them.

MR. SCHULTZ. Let's call Milt!

MR. GRAMLEY. May I make just one comment? This is Governor Gramley speaking. Am I heard out there?

SPEAKER(?). No.

SPEAKER(?). Take the chair, the hot seat.

CHAIRMAN VOLCKER. We have only two chairs from which anybody out there can hear anything, apparently.

MR. GRAMLEY. Well, one thing that seems to me evident-- unless we have had a major error in our forecast of real activity or prices in the third quarter and I don't think we have--is that velocity has dropped substantially in the quarter. I don't see any reasons for doubting the staff's view that real GNP is going down at an annual rate of about 4 percent or so, and therefore we've got only a very small increase in nominal GNP. If that view is right, then given the pattern of interest rates, we've had a tremendous drop in velocity in the third quarter. Given that fact, we have to ask ourselves whether or not what we're seeing is a reversal, or a partial reversal at least, of the movement in the money demand function that we couldn't understand in the second quarter. And if we didn't understand it in the second quarter, we also may never understand its partial move back in the third. So I believe we ought to take that into account in our thinking about how to handle this. I certainly wouldn't want to send any signals to the market that we regard this as a need for tightening up now. And I would want to use every opportunity to keep market rates from moving up too rapidly. As the figures on the table indicate, we're looking at an M-1A number for September that is still barely over the low end of the target range.

CHAIRMAN VOLCKER. Yes. Let me go over those numbers, Lyle, because I meant to do it and I forgot. I described it. I said that if the September forecast is right, with all its uncertainty, [money supply growth] is not widely out [of line] with what we were talking about at the Committee meeting. But if we look at it on an annual basis in terms of the targets--if we take the August number that we now have, which should be becoming a reasonably good number, and if we put any weight on the preliminary numbers we have for the next week--we're hovering around the lower end of the range on M-1A. On M-1B we're clearly above the middle; if the September figure came out [as projected], growth would probably get back to slightly below the midpoint. I indicated that M2 was a little weaker relative to M-1A and M-1B but M2 continues to be slightly above the upper end of its range. But that's about where we had it at the time of the Committee meeting.

So if we look at all those numbers in terms of the annual [objectives], while the rate of increase is obviously very steep in recent months, going into September and even more so going out of September it leaves us with numbers that look quite like what we were talking about at the meeting--with M-1A low, M2 high, M-1B in between. And M3, though I don't have those numbers, I think is still very much in the middle of the range. Now that final sentence depended upon September in fact not showing much change; but even the August figures are not wildly out of line at all. What is out of line obviously is the angle of inclination for July and August.

Just in reference to this August figure--and Lyle put it in the perspective of the quarter more or less--that is still somewhat disturbing to me. While one can begin making somewhat plausible explanations of why the quarter as a whole should act this way-- [attributing] it to a make-up, which is a bit reassuring in a sense--I still have some nagging questions about the whole technique in terms of how in the world the money supply can go up by \$10 billion in one

week. Again, that is not very far from half the annual growth pattern and it bothers me, particularly since it didn't all come [out] the following week.

MR. ROOS. Paul, do your people have any estimates of the monetary base for this last week, in terms of billions?

CHAIRMAN VOLCKER. Mr. Ettin is looking up the number.

MR. ETTIN. For the week of August 20th, our estimate of the monetary base would be \$158.7 billion.

MR. ROOS. Compared to what the previous week?

MR. ETTIN. Unfortunately on this table, I don't have the data prior to August 20th.

MR. BECK. And that's not seasonally adjusted.

MR. ETTIN. And that figure is not seasonally adjusted, President Roos.

CHAIRMAN VOLCKER. We don't have any of those base figures here? Does anybody here have them? It's a figure that's on the usual table that I see on a Monday but apparently it's not here on a Friday. We don't have it right here but if you want to wait for a minute, the staff will extract the table. The last time I looked--but it didn't reflect the latest week's figures--nothing extraordinary seemed to be going on [in the base]. That figure, of course, is very heavily weighted by currency. Do you have the currency component?

MR. ETTIN. Yes. Currency [growth] on the Board estimates has been relatively strong, although somewhat less than projected. Currency in July was growing at almost a 12 percent rate and in August at almost a 14 percent rate.

CHAIRMAN VOLCKER. But it didn't do anything in that week or in the subsequent week, did it?

MR. ETTIN. In the week of August 6th, it was a very small proportion of the increase. Currency only increased \$800 million in that week.

CHAIRMAN VOLCKER. I am sure the base didn't increase much in that week, simply because currency didn't go up very much. What was it the following week?

MR. ETTIN. On the 13th, it declined \$400 million to \$113 billion. Currency has not played a major role.

SPEAKER(?). Will you repeat that?

CHAIRMAN VOLCKER. Well, I am just trying to judge whether the base went up, which is the figure we haven't got. It probably didn't go up all that much if currency was acting that way. We're trying to get that figure on the telephone at the moment.

Nobody has a solution to my money supply riddle?

MR. MORRIS. Paul, this is Frank Morris. I don't have a solution but--

CHAIRMAN VOLCKER. Even speculation is welcome at this point!

MR. MORRIS. Well, it seems to me that perhaps the third quarter is stronger than we were projecting. Certainly all of the July numbers that have come in, including an increase in capital goods orders, were stronger than I had anticipated.

SPEAKER(?). In one week?

MR. SCHULTZ. Everybody took vacations in July!

CHAIRMAN VOLCKER. Nobody else cares to speculate? I keep wondering. I accept that there may be some underlying explanation in terms of the quarter. Still, it's very curious to me how we get an increase like this in a week.

MR. CORRIGAN. Paul, is the August 6th increase--now that all the numbers are in--highly concentrated?

CHAIRMAN VOLCKER. No. And Ed or Darwin Beck can probably speak more fully on this, but I have been told on a number of occasions that the increase is very widely spread.

MR. CORRIGAN. Not concentrated in big New York banks?

CHAIRMAN VOLCKER. No.

MR. ETTIN. No. And not only was it pretty widely spread geographically, it was also spread between member and nonmember banks.

CHAIRMAN VOLCKER. Mr. Ettin has the monetary base numbers.

MR. ETTIN. These are seasonally adjusted, [in billions of dollars]. On the 30th of July, \$157.164; on the 6th, \$157.816; on the 13th, \$156.851 with most of the drop that week being in currency; and on the 20th, \$158.4.

CHAIRMAN VOLCKER. That's a pretty big increase on the 20th, isn't it?

MR. ETTIN. It's a volatile series, yes.

MR. ROOS. That doesn't logically add up to what we're getting.

CHAIRMAN VOLCKER. No, there isn't much relation between those figures on a weekly basis and the deposit figures. I don't know. It just is very [odd]. I guess we have to accept that we have no explanation except fitting it into a broader context.

MR. WINN. A part of it is certainly this social security thing, but not all of it.

CHAIRMAN VOLCKER. Well, as I say, the staff tried to adjust that out, though they readily concede that adjusting it out is not an

exact science. But the total impact theoretically can't be more than 4 [billion dollars]. And they did make an adjustment, so presumably it can't really be 4.

MR. WINN. How much of it is due to the shift that's going on in the payment mechanism? Some of these banks may be trying to get ahead of the NOW account phenomenon by shifting over the ATS accounts and that sort of thing.

CHAIRMAN VOLCKER. Well, I think that may explain some of the discrepancy between M-1A and M-1B that we've been seeing for some weeks. But that can't explain the increase in both of them on the 8th. Just the fact that it comes right at the beginning of the month --and of course we've had this phenomenon before, though less big in size--makes one suspicious that there's something about the monthly patterns here that somehow affects these numbers. But I can't imagine what it would be. Well, there's no point in belaboring the issue. I'll just express my mystification about it. It's a somewhat disturbing phenomenon just from the standpoint of our inability to explain it, apart from being disturbing in terms of our objectives, the impact on the market psychology, and all the rest. But if nobody else has any comment, I guess we can draw this to a conclusion. I think the main message is that while this is very troublesome, it doesn't look quite as bad when put in a fuller perspective as it may look to us and to the market on first blush.

MR. WINN. Let's hope it doesn't look really bad to us in September.

CHAIRMAN VOLCKER. And this all is based on a presumption for which we have some [evidence]. It's more than shooting in the dark to say that August is on a downward trend after the big jump up. But I don't think we can say much more than that. And if that is borne out in September, we will be quite on track.

MR. PARTEE. If it isn't, we're--.

CHAIRMAN VOLCKER. If it isn't, we've got big problems.

MR. PARTEE. Well, we're positioned to move on up.

CHAIRMAN VOLCKER. Okay.

MR. WINN. Goodbye and have a good rest, Paul.

CHAIRMAN VOLCKER. Thank you.

END OF SESSION